

STATE OF NEW YORK  
DIVISION OF TAX APPEALS

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In the Matter of the Petition	:	
of	:	
<b>PURCHASE CORPORATE PARK ASSOCIATES II</b>	:	DETERMINATION
for Refund of Tax on Gains Derived from	:	DTA NO. 813819
Certain Real Property Transfers under Article	:	
31-B of the Tax Law.	:	

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Petitioner, Purchase Corporate Park Associates II, c/o The Related Companies, 625 Madison Avenue, New York, New York 10022, filed a petition for refund of tax on gains derived from certain real property transfers under Article 31-B of the Tax Law.

A hearing was held before Joseph W. Pinto, Jr.<sup>1</sup>, Administrative Law Judge, at the offices of the Division of Tax Appeals, 500 Federal Street, Troy, New York, on March 7, 1996 at 1:15 P.M., with all briefs to be submitted by June 11, 1996 which date began the six-month period for the issuance of this determination. Petitioner appeared by Battle Fowler LLP (Richard L. O'Toole, Esq., of counsel). The Division of Taxation appeared by Steven U. Teitelbaum, Esq. (David C. Gannon, Esq., of counsel).

***ISSUE***

Whether the amount received by petitioner for a lease surrender should be added to the amount received by petitioner for the sale of essentially the same property as consideration under Tax Law § 1440(1)(a) where the transactions occurred simultaneously and were dependent.

***FINDINGS OF FACT***

1. A stipulation was received into evidence in this matter and the Division of Taxation requested two findings of fact pursuant to 20 NYCRR 3000.15(d). The facts as set forth in the

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<sup>1</sup>On July 30, 1996 both parties were informed by letter that due to changes in job responsibilities, Administrative Law Judge Roberta Moseley Nero had been assigned to complete the case.

stipulation and the requested facts have been substantially adopted in this determination with only slight changes in the wording.

2. There are several different and related companies that were involved with petitioner in the transactions that are the subject of this proceeding. The names of such companies and the various relationships between the companies and with petitioner during the time period in question are as follows:

- Nestle USA, Inc. and Nestle Chocolate and Confection Company, Inc. (hereinafter "NCCC") were affiliates (Exhibit P,

- ¶ 7);

- Nestle USA, Inc. and NCCC were wholly-owned subsidiaries of "Nestle"<sup>2</sup> (Exhibit K ¶ 26.01, Exhibit L ¶ 17.01);

- Nestle USA, Inc. and NCCC were limited partners in petitioner (Exhibit K ¶ 26.01, Exhibit L ¶ 17.01), and;

- Nestle USA, Inc. and NCCC were limited partners in Purchase Corporate Park Associates VI<sup>3</sup> (Exhibit G, footnote 2).

3. In July 1982, petitioner agreed to lease a 35-acre parcel of unimproved land located at 1000 Manhattanville Road, Town/Village of Harrison (Purchase), New York (hereinafter "Land"), from Manhattanville College, as ground lessor, pursuant to a 99-year ground lease (hereinafter "Ground Lease") to be executed upon obtaining site plan and other required governmental approvals. The Ground Lease with Manhattanville College was executed on July 1, 1984. Construction of an office building and ancillary facilities (hereinafter "Building") on the site was completed in 1986. (Exhibit P, ¶ 3.)

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<sup>2</sup>The term "Nestle" is used since the exhibits refer to the parent company only as Nestle.

<sup>3</sup>While Purchase Park Associates VI is not involved in the present matter, it was involved in the separate issue explained in footnote 5, *infra*.

4. On July 2, 1985, petitioner entered into a lease (the "Lease") with Nestle Foods Company, subsequently known as Nestle Chocolate and Confection Company, Inc. (NCCC), pursuant to which NCCC leased the Building and subleased the Land.<sup>4</sup> (Exhibit P, ¶ 4.)

5. Due to a decline during the late 1980's in market conditions for rental office buildings in Westchester County, by late 1991 the Lease constituted an above-market obligation for NCCC. Accordingly, the Lease had a negative economic value to NCCC, and a positive economic value to petitioner. (Exhibit 2, ¶ 2.) In an effort to get out of the above-market Lease, NCCC proposed to buy itself out of the Lease, vacate the Building and relocate its operations. Petitioner was unwilling to assume the risk of an empty building in a bleak market and would not agree to NCCC's buyout proposal without a replacement tenant. Petitioner's mortgagee also would not agree. Negotiations continued and it was ultimately agreed that NCCC would pay petitioner to surrender its lease (the buyout it had originally requested), and, simultaneously, Nestle USA, Inc. would buy the building and petitioner's interest in the Ground Lease (alleviating petitioner and petitioner's mortgagee's concerns about holding a vacant building during a real estate slump). (Exhibit 2, ¶¶ 4, 5.)

6. On December 28, 1991 NCCC paid \$16,409,000.00 to petitioner to surrender the Lease (hereinafter "Lease Surrender").

7. On December 16, 1991, NCCC and petitioner filed a New York State Combined Real Property Gains Tax Affidavit and Real Estate Transfer Tax Return in connection with the Lease Surrender. This return states that no consideration was paid to the transferor, NCCC. (Stipulation, ¶¶ 5, 6.)

8. On December 23, 1991, Nestle USA, Inc. acquired fee title to the Land from Manhattanville College. (Exhibit P, ¶ 7.) On December 28, 1991 Nestle USA, Inc. entered into a contract to purchase the Building from petitioner, together with petitioner's interest as lessee under the Ground Lease, for a total purchase price of \$49,000,000.00. Petitioner filed a gains tax transferor questionnaire dated December 16, 1991 that reflected the gross consideration of

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<sup>4</sup>NCCC merged with and into Nestle Food Company effective December 28, 1991. (Exhibit G, footnote 1.)

\$49,000,000.00. Likewise Nestle USA, Inc. filed a gains tax transferee questionnaire stating that the consideration to be paid to acquire the Building together with the tenant's interest under the Ground Lease, was \$49,000,000.00. (Stipulation ¶ 7.)

9. The Division issued a tentative assessment dated March 6, 1992 increasing the consideration reported by petitioner regarding the above two transactions by including the \$16,409,000.00 reported by petitioner as a lease surrender fee in the consideration petitioner received for the sale of the building. (Exhibit G, ¶ II.) On March 9, 1992, petitioner paid the additional gains tax due as shown on the tentative assessment. (Exhibit G, caption.) On August 11, 1993, the Division received a claim for refund from petitioner. By letter dated March 18, 1994, the Division denied the claim for refund (Exhibit F).<sup>5</sup>

10. The amount of \$49,000,000.00 was an accurate reflection of the fair market value of the Building and petitioner's interest in the Ground Lease at the time of the transfer of these assets from petitioner to Nestle USA, Inc. The amount of \$16,409,000.00 was an accurate reflection of the fair market value of the Lease Surrender (i.e., what a lessee would be willing to pay and a lessor would be willing to accept to allow the lessee to get out of an above-market long-term lease). In its brief petitioner avers that the Division has not questioned the values assigned to either the Lease Surrender or the purchase of the Building. In its responding brief the Division states:

"Petitioner asserts that the Division does not contest petitioner's valuation of the building and the lease. This is not accurate. The Division considers the appraisal irrelevant because the question presented in this matter is a legal one: how does the definition of consideration at section 1440 apply to the facts of this case. Therefore, the appraisal is immaterial." (Division's brief, footnote 1.)

In its reply brief, petitioner responds as follows:

"Petitioner believes (a) the Division has not introduced any evidence concerning valuation, (b) the valuation of \$49 million for the building

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<sup>5</sup>Petitioner's original claim was for a refund in the amount of \$1,823,572.00. On March 18, 1994, the Division granted a partial refund in the amount of \$182,671.40 for an issue unrelated to the present matter. Therefore, the amount remaining at issue in the present matter is \$1,640,900.60. These amounts represent tax only, exclusive of interest. (Exhibit G, refund form, Exhibit P, footnote 1.)

and \$16.41 million for the lease surrender was negotiated by unrelated parties, was confirmed by an appraisal, and was accurate, and (c) the correctness of these valuations is extremely relevant, because they demonstrate that, when the parties engaged in two transactions involving separate interests in real estate (the sale of the building and the surrender of the lease), they applied arm's length, bona fide consideration to each property interest." (Petitioner's reply brief, p. 1.)

During the hearing held on this matter Administrative Law Judge Pinto specifically asked the Division's representative if there was any issue with regard to the numbers. The Division responded with:

"No. From our position we are working with the number, 49 million, for the sale of the building, 16.41 million for the lease hold surrender, and its the treatment of those numbers based on the facts and the gains tax, so the evaluation -- I think the appraisal comes in and says the lease was above market by about 25.8 million. We are not -- There is no dispute as to what the appraisal concludes. We are basically accepting the 49 million and 16.4 million dollar amounts that were exchanged. The numbers are not at issue. It's the application of the gains tax as to how this transaction flowed." (Tr., pp. 26,27; emphasis added.)

The appraisal submitted was entitled "REAL PROPERTY VALUATION OF 100 MANHATTANVILLE ROAD PURCHASE NEW YORK FOR PURCHASE CORPORATE PARK ASSOCIATES II" and was submitted to petitioner in June of 1993 by Peter F. Korpacz & Associates, Inc., Real Estate Appraisers & Counselors. It is a retrospective analysis providing a valuation as of December 30, 1990. The value of the property to petitioner, excluding the ground lessor's interest and subject to the NCCC lease, was \$41,000,000.00. The value of the property to petitioner without the NCCC lease was \$15,200,000.00. The appraisal explains that the fair market value of the NCCC lease to petitioner in December of 1991 was calculated by estimating the market value of the leasehold estate subject to the NCCC lease, estimating the market value of the leasehold estate free and clear of the NCCC lease, and attributing the difference between the two values as the value of the NCCC lease. Therefore the value of the lease to petitioner was \$25,800,000.00. (Exhibit O.)

The values as submitted in the appraisal and the amounts actually paid for the Lease Surrender and the sale of the Building, including the remaining interest in the Ground Lease, do

not exactly match. However, petitioner has proven that the value of the Lease Surrender was at the least the \$16,409,000.00 paid (appraisal value - \$25,800,000.00), and that the value of the Building together with petitioner's interest in the Ground Lease was not more than the \$49,000,000.00 petitioner received and reported to the Division (appraisal value - \$41,000,000.00). The Division, while expressing the opinion that these amounts are not relevant to the issue in this case, did not contest the amounts at any time during these proceedings.

11. The Lease Surrender and the transfer of the Building were two separate transactions. Although they were tied together in that both transactions had to close in order for either of them to close, the amounts paid by NCCC to get out of its lease and the amount paid by Nestle USA, Inc. to acquire the building were the result of independent negotiations and were based on the real cost to NCCC of the above-market lease and the true value of the building. (Exhibit 2, ¶ 5.)

12. Petitioner treated the \$16,409,000.00 paid by NCCC as a lease termination fee and not part of the consideration paid by Nestle USA, Inc. for the Building for gains tax, and Federal and State income tax purposes. For Federal and State income tax purposes that meant petitioner listed the \$16,409,000.00 as ordinary income rather than as a capital gain. In 1991 the maximum Federal income tax rates on ordinary income and capital gain income were 31% and 28%, respectively. Treating this transaction as a lease surrender payment and therefore ordinary income meant that petitioner's partners paid approximately \$492,270.00 more in Federal income taxes than if they had treated the income as a capital gain and part of the consideration for the building.

### ***SUMMARY OF THE PARTIES' POSITIONS***

13. Petitioner has maintained throughout these proceedings that the Lease Surrender from NCCC to petitioner and the sale from petitioner to NCCC of the Building and any rights of petitioner in the ground lease, were two separate transactions. In support of its position petitioner has submitted documentation showing that after NCCC entered into the lease with

petitioner that the commercial real estate market in Westchester County entered a slump. As a result NCCC wanted to get out of its lease since it was paying way over market for its lease. Therefore, the surrender of the lease and the fact that NCCC paid petitioner to surrender its lease reflects the economic realities of the transaction. By means of valuation evidence petitioner has attempted to show that the amounts paid for each of the transactions were fair market value and that, therefore, the Division cannot restructure petitioner's transactions.

14. The Division is arguing that pursuant to the definition of consideration contained in Tax Law § 1440(a) consideration for the sale of the building would include the \$16,409,000.00 received by petitioner for surrender of the lease because it falls within the definition of consideration and because the Lease Surrender and sale were totally interrelated and therefore not separate transactions.

### ***CONCLUSIONS OF LAW***

A. Tax Law § 1441 imposes the "gains tax" (Tax Law Article 31-B, Tax on Gains Derived From Certain Real Property Transfers) as follows:

"A tax is hereby imposed on gains derived from the transfer of real property within the state. The tax shall be at the rate of ten percent of the gain."

Transfer of real property is defined in Tax Law § 1440(7)(a) as:

"the transfer of any interest in real property by any method, including but not limited to sale, exchange, assignment, surrender, mortgage foreclosure. . . . Transfer of an interest in real property shall include the creation of a leasehold or sublease only where (i) the sum of the term of the lease or sublease and any options for renewal exceeds forty-nine years, (ii) substantial capital improvements are or may be made by or for the benefit of the lessee or sublessee, and (iii) the lease or sublease is for substantially all of the premises constituting the real property."(Emphasis added.)

Gain is defined in Tax Law § 1440(3) as:

"the difference between the consideration for the transfer of real property and the original purchase price of such property, where the consideration exceeds the original purchase price."

Consideration is defined in Tax Law § 1440(1)(a) as:

"the price paid or required to be paid for real property or any interest therein. . . . Consideration includes any price paid or required to be paid, whether expressed in a deed and whether paid or required to be paid by money, property or any other thing of value. . . ."

B. The transactions at issue in this matter, the Lease Surrender and the sale of the Building and any rights under the Ground Lease, were, as contended by petitioner, two separate and distinct transactions.

The Division in its brief argues that there were not two separate taxable transfers and that "[t]he focus of the gains tax is to look through entities to determine beneficial ownership and economic reality." (Division's brief, p. 4; emphasis added.) The Division cites the following cases as standing for that proposition: Matter of Brooks v. Tax Appeals Tribunal (196 AD2d 140, 608 NYS2d 714), Matter of 307 McKibbin Street Realty Corp. (Tax Appeals Tribunal, October 14, 1988), Matter of Howes v. Tax Appeals Tribunal (159 AD2d 813, 552 NYS2d 972), Matter of Bredero Vast Goed, N.V. v. Tax Commn. (138 Misc 2d 27, 523 NYS2d 754, affd 146 AD2d 155, 539 NYS2d 823, appeal dismissed 74 NY2d 791, 545 NYS2d 105). I agree with petitioner that this part of the Division's argument is somewhat confusing. The Division speaks of looking through entities and all of the cases it cites deal with that issue. However, in this case there is no disagreement as to the identities of the entities involved in the transactions. The Lease Surrender was a transfer between NCCC as the transferor and petitioner as the transferee. The sale of the Building and the remaining rights under the Ground Lease was between petitioner as the transferor and Nestle USA, Inc. as the transferee. Petitioner does not contest that NCCC and Nestle USA, Inc. are affiliates or subsidiaries of Nestle. The Division did request as a finding of fact that both NCCC and Nestle USA, Inc. were limited partners in petitioner. However, the Division did not appear to argue that NCCC and Nestle, USA, Inc. controlled petitioner. In any event, being a limited partner does not come close to exercising the type of power over another entity that was found in the cases cited by the Division. Therefore, I find that the principle of "looking through" the entities involved in the transactions is inapplicable to the facts of this case.

To determine whether there were two separate and distinct transfers under the facts of this case one must review the economic reality of the transactions themselves, not whether the same persons or entities controlled both transactions. In similar situations the Tax Appeals Tribunal

and the courts have found that two separate and distinct transactions took place (see, Matter of Cheltoncort Co. v. Tax Appeals Tribunal, 185 AD2d 49, 592 NYS2d 121; Matter of Perry Thompson Third Co. v. Tax Appeals Tribunal, 185 AD2d 49, 592 NYS2d 121; Matter of Loren Crossroads Associates, Tax Appeals Tribunal, August 1, 1991). These cases all dealt with the sale of property and simultaneous lease-back to the transferor of certain commercial space. They are similar to the current case in that one transaction was dependent on the happening of the other transaction. The Division's argument that because the sale of the property would not have taken place without the surrender of the lease and therefore there is only one transaction, is inconsistent with precedent that holds merely because two transactions are interdependent does not mean that there are not two separate and distinct transactions. Similarly, a finding that a lease surrender and simultaneous sale of the property are two separate transactions is consistent with precedent that holds a sale and simultaneous lease-back are two separate transactions.

Another indication that there are two separate transactions is that petitioner treated the \$16,409,000.00 received for Lease Surrender as ordinary income for Federal tax purposes. This is consistent with Federal taxation of lease surrenders where the lessor receives the compensation. The Division argues that Federal treatment of the income at issue is not controlling. This is true, however, it is indicative of the Lease Surrender being a separate transaction. (See, Matter of Philip Morris Co., Tax Appeals Tribunal, November 2, 1995; Matter of Loren Crossroads Assocs., *supra*; Matter of SKS Assocs., Tax Appeals Tribunal, September 12, 1991.)

Finally, the surrender of a lease is recognized as a transaction subject to tax pursuant to Tax Law § 1440(7)(a). (Conclusion of Law "A"; see, 52 Fulton St. Distributors, Ltd. v. Tax Commn., Special Term, Albany County, July 10, 1987, Williams, J.) Under normal circumstances the lessor would be paying the lessee to surrender the lease and any consideration received by the lessee would be taxable under 20 NYCRR 590.32. It would be inconsistent to hold that this Lease Surrender is not a separate transaction merely because of the unusual

circumstance of the lessor being the party receiving the compensation in this case due to the above-market lease situation.

C. Having determined that there are two transactions, the next question is whether it was proper for the Division to determine that the amount paid to petitioner for the Lease Surrender was part of the consideration petitioner received for the sale of the Building and its remaining rights in the Ground Lease. The Division argues that "Parent Nestle" had only to acquire the Building and Ground Lease because it would then in effect be its own landlord and have complete rights to the property. Therefore, the Division argues, there is simply no legitimate purpose served by NCCC's paying petitioner \$16,409,000.00 for the Lease Surrender and such payment is properly includable in the consideration paid to petitioner for the building. Petitioner argues that the dollar amounts associated with each transaction reflect the market value of what was exchanged and that therefore the Division cannot arbitrarily add the amounts together to determine consideration.

Both Matter of Cheltoncort Co. v. Tax Appeals Tribunal (supra) and Matter of Perry Thompson Third Co. (supra) involved the sale to a cooperative housing corporation and a lease-back to the sponsor of commercial space. Compensation to the sponsor included cash and a mortgage which were allocated to the shares of the association. No shares of the association were allocated to commercial space. There was a lease-back to the sponsor of commercial space at concededly advantageous terms. There was no portion of the purchase price allocated to the commercial space other than the lease with the advantageous terms. Therefore, it was reasonable for the Division to include the value of the lease in the consideration paid to the sponsor. In Matter of Atlantic & Hudson Limited Partnership (Tax Appeals Tribunal, January 30, 1992), it was conceded that the value of the lease was part of the consideration given to the sponsor. In none of these cases was there any argument made that the value of the lease-backs was not consideration. Petitioners were primarily arguing that they had retained ownership of the commercial areas and therefore, there was no transaction to tax.

Those cases are distinguishable from the facts in this matter. In this case a separate value was attributed to the Lease Surrender by the parties to the transaction in the amount of \$16,409,000.00. An appraisal was submitted that stated that, if anything, the Lease Surrender was worth more than that. The value of \$49,000,000.00 was attributed by the parties to the sale of the Building and the remaining rights under the Ground Lease. The appraisal submitted stated that, if anything, the sale was worth less than that. The Division does not argue with these amounts but merely states that these amounts are irrelevant, and, since both the \$16,409,000.00 and the \$49,000,000.00 fall within the definition of consideration under the gains tax, it is therefore reasonable to conclude petitioner received \$65,409,000.00 in total consideration for the sale. NCCC was committed to a lease that required it to pay far in excess of the market rate for leasing commercial real estate as that market existed in 1991. Therefore, NCCC wished to surrender the lease. Petitioner, on the other hand, did not want to let NCCC out of the lease with no immediate prospects of new tenants. The decision to sell the building to Nestle USA, Inc. at the time of the surrender of the lease to petitioner, was the result of arms-length negotiations to find a method acceptable to all parties of resolving some business difficulties. Petitioner did receive a total of \$65,409,000.00, as a result of the transactions at issue. However, the \$16,409,000.00 received for the Lease Surrender was not "the price paid or required to be paid" for the sale. It was the price required to be paid for the Lease Surrender which was a separate transaction. Therefore, the \$16,409,000.00 does not fall within the definition of consideration.

Petitioner in this case received separate consideration for separate transactions. For the Division to include the \$16,409,000.00 paid to petitioner for the surrender of the lease in the total consideration received for the building, it would have to at least allege that the allocations made by the parties to the transactions did not represent fair market value. It has not done this.

E. Petitioner mentions in its brief that the Division is not allowed to reformulate these transactions since they were not formulated with the primary purpose of avoiding the gains tax. (Tax Law § 1448[1].) The Division in its brief explains that petitioner's claim for refund was

not denied based upon Tax Law § 1448(1), but that it agrees with the petitioner that section 1448(1) would be applicable in this matter. Based upon the previous findings that there were two separate transactions and that the Lease Surrender transaction may not be added to the consideration received for the sale, petitioner did not primarily structure these transactions to avoid the gains tax. Therefore, Tax Law § 1448(1) may not be utilized to make the \$16,409,000.00 paid for the Lease Surrender subject to the gains tax.

F. The petition of Purchase Park Associates II is granted, and the remainder<sup>6</sup> of petitioner's refund claim dated August 4, 1993 in the amount of \$1,640,900.60, plus appropriate interest, is granted.

DATED: Troy, New York  
December 11, 1996

/s/ Roberta Moseley Nero  
ADMINISTRATIVE LAW JUDGE

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<sup>6</sup>As noted in footnote 5, the Division previously granted a refund of \$182,671.40, exclusive of interest, on a separate issue not part of these proceedings.